

Section 12

Employment Tax Enforcement Program

Employers are required by law to withhold employment taxes from their employees. In addition to appropriate withholding, employers are also responsible for reporting and payment of employment taxes. Employment taxes include federal income tax withholding, Social Security, and Medicare taxes.

Since the federal income tax is a "pay as you go tax" method, you must pay the tax as you earn or receive income during the year. For most employees this takes the form of income taxes withheld from their pay. Self-employed persons are also required to make estimated tax payments during the year. The pay as you go system was designed to ensure that taxpayers meet their tax obligations in a timely manner.

Social Security and Medicare taxes pay for benefits workers and their families receive under the Federal Insurance Contributions Act (FICA). Social Security taxes pay for benefits under the old age, survivors, and disability insurance part of FICA. Medicare taxes pay for hospital benefits. Each employee contributes part of these taxes and the employer pays a matching amount. Self-employed taxpayers must also pay Social Security and Medicare taxes in the form of self-employment taxes. The programs funded by employment taxes provide essential benefits to many citizens. The importance of the programs will continue to grow as more citizens reach retirement age. The Federal Unemployment Tax Act (FUTA) tax, together with state unemployment systems, provides for payments of unemployment compensation to workers who have lost their jobs.

Employer and Employee Responsibilities

Both the employer and the employee hold the responsibility for collecting and remitting withholding taxes to the Internal Revenue Service (IRS). For the most part, the employer withholds these taxes on behalf of his/her employees, but in cases where an employer does not withhold, the employee remains liable for his/her share of the taxes on his/her wages.

Self-Employed

If a worker is self-employed, he/she is liable for self-employment tax. Self-employment tax is a Social Security and Medicare tax primarily for individuals who work for themselves. It is similar to the Social Security and Medicare taxes withheld from the pay of most wage earners. A self-employed worker might have to pay estimated tax payments. You generally have to make estimated tax payments if you expect to owe taxes.

Some Common Employment Tax Evasion Schemes

Employment tax evasion schemes can take a variety of forms. Some of the more prevalent methods of evasion include pyramiding, employee leasing, paying employees in cash, filing false payroll tax returns, or failing to file payroll tax returns.

Pyramiding

"Pyramiding" of employment taxes is a practice in which a business withholds taxes from its employees but fails to remit them to the IRS. If this failure is intentional, it may be fraudulent. Businesses involved in pyramiding frequently file for bankruptcy to avoid payment of the tax liabilities accrued and then start a new business under a different name and begin the pyramiding process again.

Employment Leasing

Employee leasing is another legal business practice, which is sometimes subject to abuse. Employee leasing is the practice of contracting with outside businesses to handle all administrative, personnel, and payroll concerns for employees. In some instances, employee leasing companies fail to pay over to the IRS any portion of the collected employment taxes. These taxes are often spent by the owners on business or personal expenses. Often the company dissolves, leaving millions in employment taxes unpaid.

Paying Employees in Cash

Paying employees in whole or partially in cash without its proper inclusion in wages on the employees W-2 is a common method of evading income and employment taxes resulting in lost tax revenue to the government and the loss or reduction of future Social Security or Medicare benefits for the employee.

Filing False Payroll Tax Returns or Failing to File Payroll Tax Returns

Preparing false payroll tax returns by understating the amount of wages on which taxes are owed, or failing to file employment tax returns, are methods commonly used to evade employment taxes.

Employment Tax Enforcement Program – Frequently Asked Questions and Answers

Q.) What are the employer's responsibilities for employment taxes?

A.) Employers must report income and employment taxes withheld from their employees on Form 941, Employer's Quarterly Federal Tax Return, and deposit these taxes in full to an authorized bank or financial institution pursuant to Federal Tax Deposit Requirements. Employers are also responsible for filing a Federal Unemployment Tax Act (FUTA) return annually, and depositing those taxes.

Q.) What are the employees' responsibilities for employment taxes?

A.) Employees are responsible for paying income tax and are ultimately responsible for their share of the FICA tax. If the employer is not withholding the proper taxes, employees must remit them personally.

Employees who are concerned that their employer is improperly withholding or failing to withhold federal income and employment taxes should report their employer by contacting the IRS at 1-800-829-1040.

In cases where the employer withheld employment taxes but failed to deposit them, or failed to issue W-2s, the employee should contact the employer to request the W-2. If the employee is unable to secure a W-2 from the employer, the employee should complete and attach Form 4852, Substitute for W-2, to their tax return using the best information available to calculate the wages and the withholding. This information can often be secured from pay stubs.

Q.) What happens if the employer and employee do not comply with the employment tax laws?

A.) Evading employment taxes can have serious consequences for employers and employees. Employers may be subject to criminal and civil sanctions for willfully failing to pay employment taxes. For additional information see the Criminal Investigation Web site at:
http://www.treas.gov/irs/ci/tax_fraud/docemploymenttax.htm.

There is a loss or reduction of future Social Security or Medicare benefits for employees when employers evade employment taxes. In addition, the employee may also be affected by not qualifying for unemployment benefits.

Key Messages for IRS Criminal Investigation

Employers are required by law to withhold employment taxes from their employees.

Employees who do not have taxes withheld or who do not remit them personally, are still liable for these taxes and may not qualify for Social Security, Medicare, or unemployment benefits.

Both employer and employee hold the responsibility for collecting and remitting withholding taxes to the Internal Revenue Service (IRS).

Statistical Data:

- During Fiscal Year 2001, 31 persons were sentenced for evading the payment of employment taxes, with an average of 20 months in prison.
- Within the first seven months of Fiscal Year 2002, 27 persons have already been sentenced for evading the payment of employment taxes.

See www.treas.gov/irs/ci tax fraud alerts, Employment Tax Enforcement Program, for further statistical data, trends, and significant case summaries.